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IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

KELLEY COMPANY, INC.,

Petitioner,

v.

RITE-HITE CORPORATION ET AL.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did not the Federal Circuit err in finding that a patent owner is entitled to, as damages for infringement of its patent, profits which the patent owner lost on products other than those protected by the patent in suit, where:

(a) The Court of Appeals held that the test for recovery of such damages depends not on whether the damages flowed from invasion of property rights protected by the patent but rather on whether the competitive injury was reasonably foreseeable;

(b) The relevant market used by the Court of Appeals in determining the foreseeability of the injury to the patent owner was not related to the invention of the patent but, rather, was a market broadly defined, allowing a patent protecting only a segment of that broad market to be used to foreclose all competition in that market;

(c) The Court of Appeals concluded that this Court has not provided any guidance respecting the proper scope of damages to redress lost sales, thus inviting this Court to review and issue such guidelines;

(d) In the view of the four dissenting Circuit Judges, the majority's decision expands the property rights of the patent owner to products covered by patents whose validity has not been, and cannot be, tested and to products in the public domain;

(e) The reasoning of the majority opinion conflicts with decisions from this Court (1) limiting the economic impact of a patent to those things covered by the patent and (2) demanding that unpatented products remain freely accessible to the public; and

(f) The majority opinion is inconsistent with the constitutional purpose underlying the promulgation of the patent laws

and exceeds the constitutional power to reward inventors with the exclusive right to their discoveries by providing a disincentive for patentees to market their inventions?

2. Did not the Federal Circuit err in holding a patent owner entitled to, as a reasonable royalty for infringement, a royalty 33 times as great as the infringer's profits on the infringing product, where:

(a) The reasonable royalty was admittedly based on profits lost by the patent owner on products other than those protected by the patent in suit, rather than on what a willing licensor and a willing licensee might agree to in a hypothetical negotiation at the time the infringement began;

(b) No willing licensee could ever agree to a royalty exceeding by orders of magnitude its expected profit on the patented product; and

(c) The Court, in finding a reasonable royalty looked only to the licensor's side of the negotiating table with no attempt to balance the interests of both parties, resulting in an award viewed by the dissent as confiscatory?

PARTIES TO THE PROCEEDING

Petitioner is Kelley Company, Inc. Pursuant to Supreme Court Rule 29.1, Petitioner states that it has no parent companies and that its only subsidiaries are wholly-owned subsidiaries.

In addition to Rite-Hite Corporation, Respondents include Acme Dock Specialists, Inc., Allied Equipment Corp., Applied Handling, Inc., Anderson Material Handling Co., Block-Dickson, Inc., Robert Lund d/b/a HMH Company, HOJ Engineering & Sales Co., Inc., Johnson Equipment Co., JohnL & Associates, Inc., Keller Equipment Co., Inc., Loading Dock Equipment Co., Metro Dock Specialists, Inc., McCormick Equipment Company, Inc., Mid-South Dock Systems, Inc., Harry Monohan, Niehaus Industrial Sales, Inc., Northway Material Handling Co., Inc., Pemco Material Handling, Inc., R.B. Curlin, Inc., Rice Equipment Company, Stokes Equipment Company, Inc., Robert Soper Limited, Timbers & Associates, Inc., Todd Equipment Corporation, Thayer Systems, Inc. and W.E. Carlson Corporation.

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PETITION FOR A WRIT OF CERTIORARI TO THE
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PETITION FOR A WRIT OF CERTIORARI

Kelley Company, Inc. ("Kelley") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit.

OPINIONS BELOW

The Federal Circuit's opinion on damages, as yet unreported, is reproduced in the Appendix (App.) at 1a. The damages opinion of the United States District Court for the Eastern District of Wisconsin is published at 774 F.Supp. 1514 (E.D. Wis., 1991) and is reproduced at App. 95a. The liability decisions of the Federal Circuit (819 F.2d 1120 (Fed. Cir., 1987)) and the District Court (629 F.Supp. 1042 (E.D. Wis., 1986)) are reproduced at App. 150a and 162a, respectively.

JURISDICTION

The District Court had jurisdiction under 28 U.S.C. §§ 1331 and 1338(a). The judgment of the Court of Appeals was entered on June 15, 1995.* This Court has jurisdiction to issue the writ under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Section 284 of the Patent Act of 1952 (35 U.S.C. § 284) provides in pertinent part:

> "Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court."

STATEMENT OF THE CASE

In this case, a divided Court of Appeals for the Federal Circuit, sitting *in banc,* ruled, by a vote of eight to four, that a patent owner may recover, as damages for infringement, lost profits on sales of products other than those protected by the patent in suit. In so doing, the Court of Appeals has extended — impermissibly — the property rights secured by a patent to products covered by other patents whose validity has not been — and cannot be — tested in court, and even to products in the public domain. The decision, therefore, is wholly at odds with a long line of decisions from this Court demanding that a patent's economic impact be limited to things *covered by the patent* and requiring that unpatented products remain freely accessible to the public.**

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* The Federal Circuit has stayed the mandate pending possible review by this Court.

** See *Ethyl Gasoline Corporation* v. *United States*, 309 U.S. 436, 459 (1940); *Compco Corp.* v. *Day-Brite Lighting, Inc.*, 376 U.S. 234, 237-38 (1964); and *Sears, Roebuck & Co.* v. *Stiffel Company*, 376 U.S. 225, 231-32 (1964).

The Federal Circuit's error arose from its holding that the test for recovery of lost-profits damages was not whether the patent covered the goods involved but, rather, whether or not the profits lost, albeit on an unpatented product, were reasonably foreseeable. And that test would permit recovery for any competitive injury in a relevant market defined to encompass not only the patented product but also *all* products functionally similar thereto. But damages in patent cases have always been limited to the sort of injury the patent system was intended to prevent — damages arising from violation of the patent owner's right *to exclude others* from making and selling the patented product. By focusing the test on reasonable foreseeability, the Federal Circuit has thus enlarged patent damages beyond the intent of Congress and beyond any case ever decided, to include losses having nothing to do with the property rights protected by the patent in suit.

I. *The Background Facts*

A. *The Parties And Their Products*

Rite-Hite Corporation ("Rite-Hite") and Kelley are direct competitors in the manufacture and sale of loading dock equipment. That includes (a) truck restraints to prevent large trucks from inadvertently pulling away from a loading dock while being loaded* and (b) dock levelers, *i.e.*, adjustable bridges allowing a forklift to drive onto a truck even though the truck and the loading dock are at different heights.

Rite-Hite introduced its first restraint, an automatic device known as the ADL-100, in 1980. About fourteen months later, Rite-Hite introduced a less expensive alternative, namely the MDL-55 truck restraint, a manual device which sold for about half the price of the ADL-100. Kelley, responding to the competition of Rite-Hite's ADL-100 truck restraint, developed and began selling

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* A truck restraint is generally located adjacent a loading dock, and includes a hook that engages a truck being unloaded. The hook must be released prior to the truck leaving the loading dock.

in June of 1982 its Truk Stop restraint. Like the ADL-100, Kelley's Truk Stop was an automatic device which competed directly with the ADL-100.*

In February of 1983, long after Kelley had introduced its Truk Stop, United States Patent No. 4,373,847 ("the '847 patent") issued to Rite-Hite. The '847 patent covered a truck restraint utilizing the hook assembly found in Rite-Hite's MDL-55, and not the hook assembly found in Rite-Hite's separately patented ADL-100. Rite-Hite immediately brought suit on the '847 patent, alleging that Kelley's Truk Stop infringed the '847 patent.

B. *The Proceedings In The District Court*

The District Court found that the '847 patent was valid and had been infringed by Kelley's Truk Stop design. The District Court, however, went out of its way to note the innocent nature of that infringement; the District Court said (*Rite-Hite Corporation* v. *Kelley Company, Inc.*, 629 F.Supp. 1042, 1045-46 (E.D. Wis., 1986; App., at 163a)):

> "I do not believe the infringement was willful. I think that the Kelley people, in the spirit of good competition, Rite-Hite came out with a product, and they wanted to meet the product, and they did the best they could and certainly did not intend to infringe on that patent . . ."

The Federal Circuit affirmed liability. The case then returned to the District Court for trial on damages, following which the District Court awarded Rite-Hite damages that exceeded Kelley's net worth. The District Court judgment, including interest, awarded damages approximating $10 million on sales by Kelley of only one-half that amount.

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* The ADL-100 was covered by Rite-Hite patents not involved in this case. It was undisputed that Kelley's Truk Stop, designed to compete with the ADL-100, completely avoided infringement of Rite-Hite's patents on the ADL-100.

The bulk of the award arose from Rite-Hite's claim for lost profits. Rite-Hite had lost sales by reason of Kelley's infringement of about 80 MDL-55 restraints covered by the '847 patent, and the District Court awarded Rite-Hite lost profits on those sales. Rite-Hite sought, and the District Court also awarded Rite-Hite, lost profits for 3,243 of the more expensive (and hence more profitable) ADL-100 restraints Rite-Hite claimed would have been sold but for Kelley's infringement — even though the '847 patent in suit admittedly did not cover the ADL-100 device.*

C. *The Proceedings In The Federal Circuit*

Kelley appealed the damage award to the Federal Circuit. After briefing and oral argument to a panel of three Circuit Judges, the Court *sua sponte* ordered the appeal be heard *in banc*. After supplemental briefing and further oral argument, the Court handed down its opinion. The split among the Judges of the Court attests to the highly controversial nature of the issues. The Court of Appeals upheld the award of lost profits on the ADL-100 devices and upheld the award of a reasonable royalty based on the ADL restraints, but reversed the award of lost profits on dock levelers and the award to the sales organizations. That view was shared by eight Circuit Judges, two of whom would have affirmed the entire judgment. That creates a "majority" on the issues which Petitioner asks this Court to review. Thus, the decision joined in by six of the Judges and concurred in by two others will be referred to herein as the majority decision.

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* The District Court also awarded lost profits to Rite-Hite's independent sales organizations (ISOs) as exclusive licensees under the '847 patent; it also awarded lost profits on Rite-Hite's lost sales of dock levelers sometimes sold with the truck restraint on an entire market value theory. And, finally, the District Court awarded damages as a reasonable royalty for 502 infringing sales for which Rite-Hite was unable to show lost sales. That "reasonable royalty", of about $1,045 per infringing restraint, is slightly in excess of 75 percent of the average net sale price of Kelley's Truk Stop, and about 33 times Kelley's net profit on the entire device.

Four Circuit Judges, however, filed a dissenting opinion written by former Chief Judge Nies. The dissent insisted that the award of lost profits based on the ADL-100, and the award of a reasonable royalty likewise based thereon, should be reversed.

While the majority opinion said this Court has never provided a "definitive ruling on the proper scope of damages to redress lost sales of diverted products" (App. 14a), it nonetheless concluded that § 284 allows recovery of any damages that were reasonably foreseeable (App. 11-12a):

> "If a particular injury was or should have been reasonably foreseeable by an infringing competitor in the relevant market, broadly defined, that injury is generally compensable absent a persuasive reason to the contrary. Here, the court determined that Rite-Hite's lost sales of the ADL-100, a product that directly competed with the infringing product, were reasonably foreseeable."

That rationale — protecting the patentee's market regardless of whether it was protected by the patent which was adjudicated — impermissibly expands the scope of the patent owner's property rights to protect any product sold within that market, whether patented or not. In short, the protection afforded Rite-Hite here by the '847 patent was expanded to protect not only the thing patented — the MDL-55 — but the ADL-100 as well.*

Indeed, the Court of Appeals held that whether the patentee sells the patented device at all is "not crucial" (App. 14a) in determining lost profits, suggesting that Rite-Hite could recover lost profits on the ADL-100 device even if it had never sold the

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* The majority seemed to believe that the ADL-100 was protected and, therefore, not in the public domain because Rite-Hite had separate patents on that device (App. 15a). But those patents were never in issue and may well be invalid, placing the ADL-100 squarely within the public domain. The majority opinion never came to grips with the point that Kelley, never having been charged with infringing the ADL-100 patents, had no standing to demonstrate that their subject matter was indeed in the public domain.

patented MDL-55 restraint at all! Under that analysis, the majority would allow a patent to protect the patent owner's market from all competition even when the patent owner has sold *only* a product in the public domain.

The Court of Appeals also affirmed the District Court's award of a reasonable royalty on 502 of Kelley's machines for which Rite-Hite could not prove lost sales. That award amounted to about 50 percent of Rite-Hite's lost profits on the ADL-100 devices, to wit, more than $1,000 per device — more than 75 percent of the net sale price of Kelley's machine. Of course, that "reasonable royalty" was more than 30 times greater than Kelley's net profits on its machine (App. 73a).*

In affirming that award, the Court of Appeals said that the standard of review is whether the award is "so outrageously high or so outrageously low as to be unsupportable as an estimation of a reasonable royalty" (*Lindemann Maschinenfabrik GmbH* v. *American Hoist & Derrick Company*, 895 F.2d 1403, 1406 (Fed. Cir., 1990); App. 27-28a), but held nonetheless that the District Court's award was not clearly erroneous. In its analysis, the majority looked to the familiar test of the hypothetical negotiation between a "willing licensor/willing licensee", concluding that it was not unreasonable for the District Court to find that the patentee would license only for one-half of its expected lost profits. Citing its own rule that the determination of a reasonable royalty has nothing to do with an infringer's profit margin, the majority said (App. 28a):

> "... [t]here is no rule that a royalty be no higher than the infringer's net profit margin.... Furthermore, the fact that the award was based on and was a significant portion of the

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* The District Court rationale exposes a punitive analysis. While the District Court noted (App. 163a), that Kelley was not a willful infringer, it noted that even if lost profits were not available to Rite-Hite, it would have nonetheless awarded, as a reasonable royalty, Rite-Hite's lost profits on the ADL-100 (App. 142a).

patentee's profits also does not make the award unreasonable." [citations omitted]

The four Circuit Judges dissenting from the majority opinion warn that the Federal Circuit, with its decision in this case, has "greatly enlarged property rights for patentees" and has effectively set "new precedent for all awards of damages in future patent cases" (App. 77a). Further, the dissent says (App. 78a):

> "The majority justifies its expansion of patent protection with the explanation that the Supreme Court has provided no definitive ruling on the proper scope of damages."

The dissent points out rightly that the majority opinion expands a patent owner's property rights in a patent and allows the patent owner, for the first time, to profit on the sale of unpatented goods (App. 36a) — a result "at war with virtually every policy consideration in this area of the law" (*Aro Manufacturing Co., Inc.* v. *Convertible Top Replacement Co., Inc.*, 377 U.S. 476, 510 (1964)).*

The dissent attacks the reasoning of the majority opinion because it divorces "damages" from injury to patent rights. Judge Nies says (App. 60a):

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* Judge Nies correctly focuses on this Court's words of caution in *Aro* (377 U.S. at 510):

> "It would enable the patentee to derive a profit not merely on unpatented *rather than* patented goods — an achievement proscribed by the Motion Picture Patents and Mercoid Cases, supra, but on unpatented *and* patented goods."

Even the majority opinion admits that the ADL-100 must be treated as "unpatented" — or not covered by the patent in suit (App. 20a). But compare the majority opinion (App. 15a) where the majority opinion finds that the ADL-100 was not an acceptable non-infringing substitute because it was separately patented. The dissent likewise recognizes that the ADL-100 machine must be treated as unpatented; otherwise, Kelley was denied due process because it lacked standing to challenge the validity of any of the ADL-100 patents to show that their subject matter was actually in the public domain (App. 67a).

> "In the majority's view, the consideration of patent rights ends upon a finding of infringement. The separate question of damages under its test does not depend on patent rights but only on foreseeable competitive injury. This position cannot be squared with the premise that compensation is due only for injury to patent rights. Thus, the majority's foreseeability standard contains a false premise, namely, that the 'relevant market' can be 'broadly defined' to include all competitive truck restraints made by the patentee."

The dissent takes issue with that premise, insisting that damages must be restricted to the injury to Rite-Hite's property rights as conferred by the '847 patent (App. 33a):

> "To constitute legal injury for which lost profits may be awarded, the infringer must interfere with the patentee's property right to an exclusive market and goods embodying the invention of the patent in suit. The patentee's property rights do not extend to its market in other goods unprotected by the litigated patent."

Relying on this Court's pronouncements, Judge Nies reviewed the constitutional purpose of the patent system, designed to stimulate the patentee to place into the market new products for the benefit of the public (*Bement & Sons* v. *National Harrow Company*, 186 U.S. 70, 90 (1902); *Woodbridge* v. *United States*, 263 U.S. 50, 55-60 (1923); and *Kewanee Oil Company* v. *Bicron Corporation*, 416 U.S. 470, 480 (1974)), and wrote (App. 62a):

> "Ignoring this objective, this decision expands the property rights afforded by a patent by broadening a patentee's protected market and, as a consequence, provides a disincentive to a patentee's commerce in the patented product."

Judge Nies added (App. 66a):

> "The old rule stimulated a patentee's commerce in patented goods. The new rule makes it more profitable to the patentee

> to protect the *status quo*. The *status quo* is not 'progress in the arts.' Article I, sec. 8. I conclude the majority's rule is a wrong interpretation of the statute, indeed, may exceed the constitutional power to provide inventors with the exclusive right to their discoveries."

The dissent was equally critical of the majority's reasoning anent the reasonable royalty issue, noting that the reasonable royalty is an award "for the use of the invention by the infringer", just as the statute says. For that reason (App. 74-75a):

> "Rite-Hite's lost profits on ADL-100s and levelers are not factors in calculating that value for the same reasons lost profits are not awardable for the goods. Neither is part of the exclusive market granted by the '847 patent. The '847 patent may not be used 'for the exploitation or promotion of a business not embraced within the patent.' *Ethyl Gasoline*, 309 U.S. at 459. A royalty based on the unprotected goods unlawfully exploits the patent."

The dissenting Judges found the District Court's award outrageously high, labeling the reasonable royalty as "confiscatory" (App. 77a).

REASONS FOR GRANTING THE PETITION

This case presents the question of whether a patentee can expand the scope of his patent, under the guise of lost-profits damages for infringement, to protect things that are unpatented or covered only by other, unlitigated patents. The dissent characterizes the majority opinion as using the damages provision of 35 U.S.C. § 284 as a "tool to expand the property rights granted by a patent" (App. 32a). Indeed, the dissent suggests (App. 66a) that the majority's interpretation of that statute "may exceed the constitutional power to provide inventors with the exclusive right to their discoveries".

And, the importance of that issue was dramatically spelled out in the dissenting opinion, with a warning that the majority has set "new precedent for all awards of damages in future patent cases" (App. 77a). The majority said that this Court has provided "no definitive ruling on the proper scope of damages to redress lost sales of diverted products" (App. 14a).*

This case also presents the intertwined issue of whether damages in the form of a "reasonable royalty" can be based on the profitability, not of the patented product but, rather, an unpatented product sold as an alternative to the patented product. Just as clearly, the Federal Circuit's award of damages based on the profitability of an unpatented product expands the property rights granted by a patent.

When the award of damages is based on the profitability of a product other than that covered by the patent and is, in the words of the dissent, "confiscatory", the precedent-setting decision of the Court of Appeals is deserving of special scrutiny. By approving an award of a reasonable royalty orders of magnitude in excess of the infringer's profit, the Federal Circuit here has wiped out the "willing seller/willing buyer" rule which the courts have followed in setting royalties for the last 65 years. Plainly, an award exceeding 33 times an infringer's profit is wholly inconsistent with the "willing buyer" analysis; no competitor could ever accept a reasonable royalty resulting in royalties far in excess of its profit.

This Court should act in this case and grant certiorari. Otherwise, the national precedent set in this case will expand patent

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* This Court has stressed the importance of the Federal Circuit considering — and definitively settling — patent law issues (*Cardinal Chemical Company* v. *Morton International, Inc.*, 508 U.S. _____, 113 S.Ct. 1967, 1971 (1993)). What the Federal Circuit does in a precedent-setting case such as this one is a matter of "special importance" to the entire United States. Where the Federal Circuit has acknowledged lack of guidance from this Court, it is especially important that this Court grant certiorari on issues materially affecting damage awards in patent cases.

rights to allow recovery of damages based on unpatented products, and in the process, will rewrite the law of patent damages.

I. *The Federal Circuit Impermissibly Expands Patent Rights To Protect Unpatented Products*

As the dissent repeatedly emphasizes, the majority opinion in this case expands property rights granted by a patent to include unpatented products. And that has always been impermissible under the law.

A. *The Dissent Correctly States That The Majority Decision Expands Patent Rights Well Beyond The Scope Of The Invention Patented*

This Court has consistently held that a device, when unprotected by federal patent laws, is in the public domain and can be copied freely by anyone (*Compco Corp.* v. *Day-Brite Lighting, Inc.*, 376 U.S. 234, 237 (1964)):

> "To forbid copying would interfere with the federal policy found in Art. I, § 8, cl. 8, of the Constitution and in the implementing of federal statutes, of allowing free access to copy whatever the federal patent and copyright laws leave in the public domain."

This Court has made that point in other contexts as well (*Lear, Incorporated* v. *Adkins*, 395 U.S. 653, 668 (1969)):

> ". . . federal law requires that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent."

See also, Motion Picture Patents Company v. *Universal Film Manufacturing Company*, 243 U.S. 502, 517 (1917) and *Mercoid Corporation* v. *Mid-Continent Investment Company*, 320 U.S. 661, 664-65 (1944). And, those holdings have been extended by this Court to bar compensation for competitive injury in unpatented

things as well (*Sears, Roebuck & Co.* v. *Stiffel Company*, 376 U.S. 225, 232-33 (1964)):

> "... [B]ecause of the federal patent laws a State may not, when the article is unpatented and uncopyrighted, prohibit the copying of the article itself or *award damages for such copying.*" [emphasis supplied]

The scope of a patentee's protected market is determined by, and limited to, what the patent covers. It is the nature of the patent right which forms the basis for determination of a patentee's remedies for infringement (*Continental Paper Bag Company* v. *Eastern Paper Bag Company*, 210 U.S. 405, 430 (1908)). And this Court has made it equally clear that the scope of protection afforded by a patent is measured by the invention covered thereby (*Ethyl Gasoline Corporation* v. *United States*, 309 U.S. 436, 459 (1940)):

> "The patent monopoly of one invention may no more be enlarged for the exploitation of a monopoly of another, ... than for the exploitation of an unpatented article, ... or for the exploitation or promotion of a business not embraced within the patent." [citations omitted]

Here, it is undisputed that the ADL-100 market, protected by the majority opinion, is a business "not embraced" within the patent in suit.

But, that is precisely what the Court of Appeals has done here. It protects Rite-Hite's market in the patented MDL-55 devices *and* Rite-Hite's market in the unpatented ADL-100 devices — a business not within the scope of the '847 patent. Indeed, the majority has admittedly extended damages to "competitive injury" broadly, so long as it is reasonably foreseeable, in the relevant market "broadly defined" (App. 11-12a) — without regard to whether that market is protected by the litigated patent or not.

Such broad-brush reasoning plainly expands the patentee's protected market beyond the patented product to embrace other devices sold as alternatives, whether patented or not. The majority says that cases like *Ethyl Gasoline Corporation* v. *United States*, 309 U.S. 436, 459 (1940) are inapposite because the patent owner here did not seek an injunction against the sale of unpatented products like the ADL-100 but, rather, sought, once infringement of a valid patent was determined, damages for lost sales of those unpatented products stemming from that infringement (App. 12-13a). But as the dissent points out, the relevant market for determining damages is confined to the market for the invention in which the patentee holds exclusive property rights (App. 60a):

> "This reasoning awards patent infringement damages as if for a kind of unfair competition with a patentee's business. However, infringement of a patent is not a species of common law unfair competition; it is a distinct and independent federal statutory claim" (App. 61a).

That, of course, is consistent with this Court's holdings of damages in other statutory wrongs where the public purpose of a statute as measured by Congress' intent determines the type of injury for which one may be compensated. In the antitrust context, an antitrust claimant must prove an antitrust injury, *i.e.*, the type of injury the antitrust laws were intended to prevent (*Brunswick Corporation* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977)). *See also, Associated General Contractors, Inc.* v. *California State Council of Carpenters*, 459 U.S. 519, 538-40 (1983).

By the same reasoning, a patentee must prove the type of injury the patent laws were intended to prevent, namely a violation of its exclusive rights secured by the patent law. But Rite-Hite's exclusive rights here resided solely in the particular truck restraint covered by the litigated patent. It had no exclusive market in truck restraints generally. The majority of the Federal Circuit, having given Rite-Hite protection in the market of truck restraints

generally, regardless of whether they were covered by the '847 patent, gives that patent an effect far beyond the exclusivity it conferred.*

Indeed, as the dissent observes, the majority extends Rite-Hite's patent protection not only beyond the scope of the patent rights secured, so too its decision paves the way for the protection of unpatented goods — products in the public domain (App. 35a). That same type of broadening of patent protection to products not within the scope of a legal monopoly was rejected in *Velo-Bind, Incorporated* v. *Minnesota Mining & Manufacturing Company*, 647 F.2d 965 (9th Cir., 1981). In that case, the patent in suit covered binding machines which were used in combination with unpatented paper, plastic strips and covers. The lower court awarded in excess of $3 million as compensation for Velo-Bind's lost profits on the unpatented materials used with the patented binding machine. In arguing to sustain the damage award on appeal, Velo-Bind made the same argument that the majority did here, namely that it (and Rite-Hite here) never sought to illegally tie the sale of the unpatented supplies to the patented binding machine. The Ninth Circuit soundly rejected that argument (647 F.2d at 972):

> "[Velo-Bind] concedes that it may not tie the sale of unpatented supplies to the sale of machines. To do so would violate antitrust laws. . . . It would also be a misuse of the patent precluding its enforcement . . . Yet Velo-Bind's claim

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* As the dissent observes, a patentee's right to exclude is protected by the statutory right to an injunction under 35 U.S.C. § 283. And that right is generally protected, regardless of whether the patentee offers an invention to the public or not (*Continental Paper Bag Company* v. *Eastern Paper Bag Company*, 210 U.S. 405, 424-30 (1908); App. 45a). Even under the majority's view, a patentee is thus provided a *quid pro quo* for his public disclosure of the invention. And, of course, it is the right to an injunction which is supposed to stimulate the patentee to offer new products to the marketplace embodying his invention; in return for its complete disclosure, the patentee is entitled to a limited period of exclusivity to make and sell the patented product but no other product outside his patent rights.

> for damages comes close to asking the court to give *de facto* recognition to a tieing relationship which would be illegal." [citations omitted]

The majority, after noting that Rite-Hite did not seek to enjoin the sale of products not covered by the '847 patent in suit, nonetheless has used the '847 patent in suit to protect Rite-Hite's market in unpatented truck restraints sold as alternatives to those covered by the patent in suit. The Federal Circuit majority ruling here is thus a *de facto* holding that the patent in suit gives Rite-Hite a protected position in the entire market of truck restraints, and not just those truck restraints covered by the litigated patent.

In sum, just as the dissent says, the majority decision does unlawfully expand the coverage of the patent in suit to protect Rite-Hite's entire market rather than just its market for the restraints covered by the patent.

B. *The Federal Circuit Decision Likewise Enforces A Patent Whose Validity Has Not Been Subjected To The Required Judicial Scrutiny*

Up to the present, the traditional test governing an award of lost profits in the Federal Circuit was *Panduit Corp.* v. *Stahlin Bros. Fibre Works, Inc.*, 575 F.2d 1152, 1156 (6th Cir., 1978), a leading case which was written by the Honorable Howard T. Markey, then Chief Judge of the Court of Customs and Patent Appeals (and later the first Chief Judge of the Federal Circuit) sitting by designation in the Sixth Circuit. In *Panduit*, the Court held that the standard for obtaining as damages the profits on the sales that a patentee would have made absent the infringement requires a showing of (1) demand for the patented product; (2) absence of acceptable non-infringing substitutes; (3) manufacturing and marketing capability to exploit that demand; and (4) the amount of profit the patentee would have made.

The rationale in *Panduit* is that, in a two-supplier market, it is reasonable to assume that "but for" the infringer's sales of the patented product, the patentee normally would be expected to make the sale. But the Federal Circuit created a lost profits remedy even where others are present in the market, apart from the patentee and the infringer. In those situations, the patentee would be entitled to lost profits based on its market share (*State Industries, Inc.* v. *Mor-Flo Industries, Inc.*, 883 F.2d 1573, 1578 (Fed. Cir., 1989)).

And the Court of Appeals, following *Panduit*, has insisted until now upon proof of demand for the *patented* product, not some other product sold as an alternative to it. But here, the majority has found that the ADL-100 *was* a substitute for the patented device, though not available to Kelley because it was *separately* patented (App. 15a):

> "Such a substitute was not an 'acceptable, non-infringing substitute' within the meaning of *Panduit* because, being patented by Rite-Hite, it was not available to customers except from Rite-Hite. . . . If, on the other hand, the ADL-100 had not been patented and was found to be an acceptable substitute, that would have been a different story, and Rite-Hite would have had to prove that its customers would not have obtained the ADL-100 from a third party in order to prove the second factor in *Panduit*."

But as the dissent recognizes, the majority's view is fundamentally unfair and perhaps unconstitutional. While the Court of Appeals said the ADL-100 restraints were not non-infringing alternatives because they were patented, Kelley had no basis to challenge the validity of the ADL-100 patents and show that the subject matter was in the public domain, because Rite-Hite never charged Kelley with infringement of those patents (*Altvater* v. *Freeman*, 319 U.S. 359, 363-65 (1943); *BP Chemicals Limited* v. *Union Carbide Corporation*, 4 F.3d 975, 978 (Fed. Cir., 1993)). As the dissent said (App. 67a):

> "Given that Kelley has had no legal basis for bringing a declaratory judgment action challenging the unlitigated patents (never having been charged with their infringement), the majority imposes liability and overlooks the unfairness in its theory. If the unlitigated patents are significant to damages, Kelley deserves an opportunity to defend against them. A clearer denial of due process is rarely seen."

The majority decision here protects the market covered by Rite-Hite's unlitigated ADL-100 patents, plainly a repression of competition, all without judicial scrutiny of the patents on the ADL-100 which this Court has so frequently demanded (*Cardinal Chemical Company* v. *Morton International, Inc.*, 508 U.S. _____, 113 S.Ct. 1967, 1971 (1993); *Bonito Boats, Inc.* v. *Thunder Craft Boats, Inc.*, 489 U.S. 141, 146 (1989)).

In sum, the majority decision not only gives protection to segments of the market unprotected by the litigated patent, it just as clearly enforces a patent owner's monopoly on products *other* than those covered by the patent, without giving the infringer an opportunity to test the validity of those other patents.*

II. *The Majority View In This Case Conflicts With The Decisions Of Every Court That Has Ever Dealt With The Issue*

Not only does the majority decision of the Federal Circuit represent a drastic change in the law, so too is it in conflict with virtually every prior decision dealing with patent damages decided either by this Court or the regional courts of appeals.

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* As Judge Nies points out in her dissent, the majority decision virtually obliterates the patent term limit of 35 U.S.C. § 154 "by protecting the profits on goods made under one patent for infringement of another". That has the effect, as Judge Nies noted, of expanding the term of protection as well as the scope of protection (App. 67-68a).

Damages in patent cases are governed by 35 U.S.C. § 284, mandating an award of damages "adequate to compensate for the infringement". The statute, all agree, sets as a floor for such damages a reasonable royalty "for the use of the invention by the infringer".

As the dissent points out (App. 42a), while the statutory remedies have been modified in other ways, a patentee has been entitled to actual damages since the beginning of the Nineteenth Century (*Seymour* v. *McCormick*, 57 U.S. (16 How.) 480, 488-89 (1854)). Immediately prior to 1946, the patent statute provided for recovery of "damages" that the patentee has sustained — an award which could be the amount of a patentee's lost profits by diversion of its sales of patented goods, the amount of an established royalty or a reasonable royalty. As this Court observed in *Aro Manufacturing Co., Inc.* v. *Convertible Top Replacement Co., Inc.*, 377 U.S. 476, 505 (1964), the statute was amended by the 1946 Amendment to its present form in which only "damages" are recoverable. The 1952 codification did not change the substance of allowable damages, but merely resulted in reorganization of the language to clarify the statute (*Aro*, 377 U.S. at 505).

Even before the 1952 Act, this Court took care in attributing a patentee's recovery to what was protected by the patent in suit. In *Dobson* v. *Hartford Carpet Company*, 114 U.S. 439, 445 (1885), this Court noted:

> "The patentee must in every case give evidence tending to separate or apportion the defendant's profits and the patentee's damages between the patented feature and the unpatented features, and such evidence must be reliable and tangible, and not conjectural or speculative or he must show by equally reliable and satisfactory evidence that the profits and damages are to be calculated on the whole machine, for the reason that the entire value of the whole machine as a marketable article is properly and legally attributable to the patented feature."

Indeed, this Court had, in those early years, rejected the proposition that a patentee may recover profits attributable to other patents on a device competitive with the patented technology (*Blake* v. *Robertson*, 94 U.S. 728, 733-34 (1877); *Yale Lock Manufacturing Company* v. *Sargent*, 117 U.S. 536, 549-52 (1886)).

So too, this Court, in *Crosby Steam Gage and Valve Company* v. *Consolidated Safety Valve Company*, 141 U.S. 441 (1891), noted that damages turn on the patentee's use of his patent to market goods (141 U.S. 441, 452):

> "If there had been an award of damages, and the loss of trade by the plaintiff, in consequence of the competition by the defendant, had been an element entering into those damages, it would have been a material fact to be shown by the plaintiff that it was putting on the market goods embodying the [patented] invention."*

As the dissent concluded, the present language of § 284 is reenacted statutory language and it is, therefore, reasonable to infer, as this Court concluded in *General Motors Corporation* v. *Devex Corporation*, 461 U.S. 648, 653-54 (1983), that Congress intended to adopt the established judicial interpretation (App. 43a).

And, of course, the rationale for this Court's holdings is obvious. A patent, conferring the right to exclude others from making, using or selling the *invention*, was created for a public purpose "to promote the progress of science and the useful arts" as our Constitution demands. As this Court noted in *Mercoid Corporation* v. *Mid-Continent Investment Company*, 320 U.S. 661, 666 (1944), a patent is a privilege:

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* Compare this Court's statement of the law with the majority's statement that whether a patentee sells his patented invention is not "crucial" in determining lost profits (App. 14a).

> "... which is conditioned by a public purpose. It results from invention and is limited to the invention which it defines."

As this Court observed in *Kendall* v. *Winsor*, 62 U.S. (21 How.) 322, 327-28 (1859), patents are not private in nature and were never designed for an inventor's "exclusive profit or advantage". The primary object of the system as a whole was to benefit the community at large. It has never been permissible to project the economic effect of a valid patent beyond the limits of the invention it defines. And that rule obtains whether a patentee's other products sold as alternatives to a patented product are or are not themselves separately patented. As this Court said in *Ethyl Gasoline Corporation* v. *United States*, 309 U.S. 436, 459 (1940)):

> "The patent monopoly of one invention may no more be enlarged for the exploitation of a monopoly of another ... than for the exploitation of an unpatented article. ..." [citations omitted]

Not only is the majority's decision irreconcilable with the decisions from this Court, so too it also conflicts with virtually every circuit. The dissent (App. 54-57a) reviews decisions from every circuit except for the First and Eighth Circuits, showing that each such circuit has adhered to the basic tenet that patent damages protect a patentee's market for its own goods embodying the patented invention and do not extend that protection to other markets beyond the scope of the patent. The dissent also shows (App. 57-59a) that the Federal Circuit, until this case was decided, has uniformly ruled in accord with the decisions of other circuits.

That is persuasive evidence that the Federal Circuit has erred grievously.

III. *The Majority Decision Is Inconsistent With The Constitutional Basis For The Patent System*

The majority opinion, as the dissent observed (App. 61a), ignores long standing precedent limiting a patentee's compensable injury to the diversion of sales a patentee would have made of products containing the patented invention, declaring instead that whether a patentee sells its patented invention is not "crucial" to determining lost-profits damages (App. 14a). Wholly apart from the fact that that rationale obliterates over a century of precedent, it likewise misconceives the purpose of the patent laws in the first instance. As we have noted, this Court long ago said that patent rights are not created purely to confer private benefit. While private benefit is sometimes a result, the benefit to the public as a whole is, without doubt, the primary object in the constitutional provision empowering Congress to establish a patent system (*Kendall* v. *Winsor*, 62 U.S. (21 How.) 322, 327-28 (1859); *Mercoid Corporation* v. *Mid-Continent Investment Company*, 320 U.S. 661, 666 (1944)).

The objective of the system, as this Court noted in *Kewanee Oil Company* v. *Bicron Corporation*, 416 U.S. 470, 480 (1974), is:

> "The productive effort thereby fostered [by the patent laws] will have a positive effect on society through the introduction of new products and processes of manufacture into the economy, and the emanations by way of increased employment and better lives for our citizens."

As the dissent concludes, the majority decision provides a disincentive to a patentee's commerce in patented products — the very undertaking which the framers of the Constitution sought to foster (App. 62a). Judge Nies notes that, under the entire market value rule, the recovery of damages based on the value of the entire apparatus is only permitted where the patented feature forms the basis for customer demand (*State Industries, Inc.* v. *Mor-Flo Industries, Inc.*, 883 F.2d 1573, 1580 (Fed. Cir., 1989); App. 65a).

Judge Nies goes on to point out how the majority's ruling provides a "disincentive" for marketing of the patented feature* (App. 65a):

> "The majority agrees that if a patented improvement is used in a device of the patentee with which the infringer competes, to recover lost profits on the entire device, the patentee must prove that the patented feature is the basis for consumer demand for the entire product; but if the patentee substitutes other unprotected technology for the patented improvement, then the patentee is entitled to all of its lost profits. Surely this negates the stimulus for a patentee to put out products with the [patented] improvement."

It is hardly surprising, therefore, that the dissent concludes that the majority, in its interpretation of the statute, may well have exceeded the constitutional power to provide inventors with the exclusive right to their discoveries (App. 66a).

IV. *The Majority Test Of Reasonable Foreseeability Is Internally Inconsistent And Wholly Unworkable As Precedent*

The standard adopted by the majority for damages — reasonable foreseeability — has never played a role in the law of patents. As the dissent points out, a finding of infringement in the first instance has never depended upon a finding of negligence or culpable intent on the part of the infringer (App. 69a). The dissent makes the point (App. 62a):

> "'Foreseeability' is a wholly anomalous concept to interject as the basis for determining legal injury for patent infringement.

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* As the dissent also points out, the patent system should stimulate a patentee to put new products into the marketplace during the patent term, and not compensate the patentee while the public benefit from the invention is delayed for 17 years, until it falls into the public domain. Compensation for lost profits for injury to that exclusive market has, up until the decision in this case, provided the incentive to achieve that objective (App. 61a).

> While unknowing infringers cannot 'foresee' any injury to the patentee, they are subject to liability for damages, including lost profits, for competition with the patentee's patented goods. Now they will be liable for diverting sales of the patentee's unprotected competitive products as well."*

That the "foreseeability" standard is unworkable is shown by the majority's opinion in this case. The majority upheld the District Court's award on the basis of lost sales of the unpatented (or not covered by the patent in suit) ADL-100 device on the theory that those lost sales were reasonably "foreseeable". But then the majority turned around and denied Rite-Hite's lost profits on sales of dock levelers frequently sold with truck restraints on the theory that the latter are neither competitive nor function with the patented invention (App. 20-21a). The distinction which the majority draws in that regard has nothing to do with reasonable foreseeability and is itself a convincing demonstration of the unworkability of the "foreseeability" standard adopted by the majority.

And, of course, we must not forget the entire market value rule itself, approved by the majority opinion, which allows for an award of damages, based on an entire device, if it can be shown that the patented feature forms the basis for the consumer demand for that device (*State Industries, Inc.* v. *Mor-Flo Industries, Inc.*, 883 F.2d 1573, 1580 (Fed. Cir., 1989); App. 17-18a). What the majority fails to recognize is that the entire market value rule is redundant in light of its foreseeability standard. Nonetheless, the entire market value rule remains and forms the basis for an award of damages for

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* The dissent also notes, and correctly so, that the majority's foreseeability standard is inconsistent with the requirement for a patentee to mark its patented goods to prevent innocent infringement as prescribed by 35 U.S.C. § 287(a). As the dissent observes, to hold that a patentee may recover damages respecting injury to its business in products that do not embody the invention — either unmarked or marked with a number of a different patent — would treat a patentee that does not practice its invention more favorably than one that does (App. 62-63a).

those unpatented components which, according to the majority's current view, are functionally interrelated with the patented feature. Foreseeability has nothing to do with that standard and, thus, "foreseeability" is wholly inconsistent with the entire market value rule.

The foreseeability standard, as the dissent points out, is just unworkable (App. 64-66a).

V. *The Majority Likewise Extends A Patentee's Property Rights In The Patent By Basing A Reasonable Royalty On The Profitability Of An Unpatented Product Sold As An Alternative*

Under the law of the Federal Circuit before this case, a reasonable royalty has always been a hypothetical royalty for the use of the patented technology by the infringer, to be calculated as if the parties negotiated at arm's length as a willing licensor and a willing licensee on the date when the infringement began (*State Industries, Inc.* v. *Mor-Flo Industries, Inc.*, 883 F.2d 1573, 1580 (Fed. Cir., 1989); *Hanson* v. *Alpine Valley Ski Area, Inc.*, 718 F.2d 1075, 1079 (Fed. Cir., 1983); App. 74a)).

Under the express requirement of the statute, a reasonable royalty determination hinges on the value of the invention in the marketplace, the statute prescribing a reasonable royalty "for the use of the invention by the infringer" (35 U.S.C. § 284). Where the majority went astray here was its approval of basing the value of the invention on Rite-Hite's lost profits on the ADL-100 — a product not even embodying the invention.

As the dissent observed, there is something very wrong when a reasonable royalty is determined, based upon a hypothetical negotiation of a willing licensor/willing licensee, to arrive at an amount 33 times greater than Kelley's net profit on the infringing device (App. 73-74a). In support of that view, the majority concluded that there is no rule requiring that the infringer's profit

be taken into account in determining what is "reasonable" (App. 28a).

What remains unanswered by the majority opinion is how Kelley, as a willing licensee, could ever agree to a royalty which resulted in a loss — and a big one — for each product sold. That is wholly inconsistent with the majority's analysis. As the dissent observed, the majority here approved the District Court's analysis which was limited to an assessment of Rite-Hite's side of the negotiating table, with no attempt to balance the interests of both parties as the law demands (App. 75a). As the dissent noted (App. 77a):

> "A royalty which on any reasonable projections respecting the innocent infringer's business would be confiscatory violates that balance. It is simply beyond reality to infer that the management for the five hundred employee-owners of Kelley would have negotiated a royalty which, it was evident at the time, would destroy their business and jobs."

The majority's approval of a reasonable royalty orders of magnitude in excess of the infringer's expected profits was simply wrong. It was based on the profitability of an unpatented product sold as an alternative to that covered by the patent and likewise illegally extends the scope of patent protection afforded by the litigated patent.

CONCLUSION

The Federal Circuit decision in this case goes too far, and unlawfully extends the protection afforded by a patent in a decision that will likely affect every patent case. In light of the national importance of that issue, this Court should surely intervene and grant certiorari.

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